No. 12,277

IN THE

United States Court of Appeals
For the Ninth Circuit

LOUISE K. GODFREY,

Appellant,

vs.

JAMES G. SMYTH, United States Collector of Internal Revenue at San Francisco, California,

Appellee.

On Appeal from the United States District Court for the Northern District of California, Southern Division.

BRIEF FOR APPELLEE.

THERON LAMAR CAUDLE,
Assistant Attorney General,

ELLIS N. SLACK,
LEE A. JACKSON,
L. W. POST,
Special Assistants to the Attorney General,

FRANK J. HENNESSY,
United States Attorney,

C. ELMER COLLETT,
Assistant United States Attorney,
Post Office Building, San Francisco 1, California,

Attorneys for Appellee.

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BRIEF FOR APPELLEE.

OPINION BELOW.

The District Court did not write an opinion. Its findings of fact and conclusions of law (R. 18-30) are not officially reported. Its order denying the taxpayer's motion to amend findings and judgment and for a new trial (R. 42-44) is likewise unreported.

JURISDICTION.

This appeal involves estate taxes. The decedent died on November 6, 1944. (R. 24.) The estate taxes were paid as follows: $10,786.15 on June 13, 1945 (R. 25); $4,290.76 on November 27, 1945. (R. 26.) Of these taxes so paid, the sum of $10,088.90 is in dispute. (R. 11.) Claim for refund was filed on December 3, 1945, and rejected on August 26, 1947. (R. 26, 77.) Within the time provided in Section 3772 of the Internal Revenue Code and on September 17, 1947, the appellant (hereinafter called the taxpayer) brought this action in the District Court for recovery of $10,000 of the taxes alleged to have been illegally collected, naming both the United States and the Collector as defendants. (R. 2-10.) On November 25, 1947, the complaint was amended so as to omit the United States as a party defendant and to pray for judgment for the sum of $10,088.90 together with interest and costs against the appellee, hereinafter called the Collector. (R. 11.) Jurisdiction was conferred on the District Court by 28 U.S.C., Sec. 1340. The judgment was entered on January 24, 1949, dismissing the taxpayer's action with costs. (R. 30-32.) On February 1, 1949 the taxpayer filed a motion to amend the findings and judgment and for a new trial (R. 32-42) which the District Court denied on May 2, 1949. (R. 44.) Within sixty days and on May 27, 1949, the taxpayer filed a notice of appeal. (R. 45.) Jurisdiction is conferred upon this Court by 28 U.S.C., Sec. 1291.

QUESTION PRESENTED.

Whether the proceeds of two policies of insurance on the life of the decedent were properly included in his gross estate for purposes of the federal estate tax under Section 811 of the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED.

These are set out in the Appendix, *infra.*

STATEMENT.

The District Court found the following facts (R. 18-29):

The plaintiff (hereinafter called the taxpayer) is the widow, was the executrix under the last Will and Testament of William S. Godfrey, Jr., deceased (hereinafter called the decedent), and his sole distributee under the Decree of Distribution in the matter of his estate. (R. 18.)

Defendant James G. Smyth is, and at the time of the payments of tax herein mentioned was United States Collector of Internal Revenue at San Francisco, California. (R. 18.)

April 24, 1924, the decedent took out a policy of life insurance on his life in the New York Life Insurance Company, numbered 8 751 507, in the sum of $15,000 in favor of his executors, administrators, or assigns or his duly designated beneficiary for an annual premium which he agreed to pay. (R. 19.)

Subsequently, the decedent requested taxpayer, then his wife and now his widow, to consent to the execution of a trust agreement in the proceeds of the policy, and taxpayer stated that she would do so and the decedent stated that he would always keep up the policy intact for the benefit and protection of taxpayer and her children. At and before the signing by her of the consent to the trust agreement, the decedent stated to taxpayer that he would see that the premium payments would be kept up and that she and the children would be the beneficiaries in the manner subsequently effected by the trust agreements. At the time the discussion took place, the greatest bond of affection and confidence existed between the insured and his wife. By the creation of the trust, the insured was seeking to make the best possible provision for his wife and his children. The trust had the effect of making the wife and children beneficiaries and of conserving the funds all for their benefit. But no contract existed nor was the community character of the property destroyed. Neither the decedent nor taxpayer intended thereby to enter into a contract and neither statement was made as a condition to or because of a statement or promise by the party to whom it was made. It is not true that there was thereby transferred to taxpayer and her children the whole beneficial interest in the policy or that the community character of the property of the insured and his wife in the policy was destroyed. (R. 19-20.)

Thereafter, on June 5, 1924, the decedent entered into a trust agreement with the insurance company by the terms whereof the company agreed to receive, as trustee, the proceeds of the policy and to pay one-half the proceeds and interest thereon, to taxpayer, the first beneficiary, if living, in monthly installments of $50 each and, if she should die before the insured, to pay such one-half to the daughter of taxpayer, but if both of such beneficiaries died, then the money should be paid to the executors or administrators of the last surviving beneficiary. (R. 20-21.)

The decedent made a similar contract with the insurance company, whereby he appointed it trustee of the other half of the proceeds of the policy, and the company agreed to receive, as trustee, from itself as insurer, one-half of the proceeds of the policy, and to pay one-half of the proceeds and the interest thereon to taxpayer, as beneficiary, in monthly installments of $50 each, and, in the event of the death of taxpayer before the insured, to pay such one-half to the son of taxpayer, and in the event of the death of both taxpayer and the son, to pay one-half of the proceeds to the executors or administrators of the last surviving beneficiary. (R. 21.)

The decedent always did keep the policy alive, intact and paid up for the protection of taxpayer and her children and paid the annual premiums thereon until he became disabled in 1937, after which the premiums were, by the terms of the policy, waived. (R. 21.)

On December 21, 1929, the decedent took out a further policy of life insurance with the New York Life Insurance Company numbered 10 899 287 in the sum of $25,000, payable to the executors, administrators or assigns of the insured or his duly designated beneficiary, for an annual premium which the insured agreed to pay. (R. 21-22.)

On February 24, 1930, the insured requested taxpayer to consent to his entering into a trust agreement with the insurance company in the proceeds of policy No. 10 899 287 and taxpayer stated that he might enter into such trust agreement and insured stated to taxpayer that he would keep up the policy intact and in full force and effect for the benefit and protection of taxpayer and her children, and the insured then and there stated to taxpayer that he would see that the premium payments would be kept up and that she and the children would be the beneficiaries in the manner subsequently effected by the trust agreements, but no contract existed nor was the community character of the property destroyed. Neither the decedent nor taxpayer intended thereby to enter into a contract and neither statement was made as a condition to or because of a statement or promise by the party to whom it was made. It is not true that there was thereby transferred to taxpayer and her children the whole beneficial interest in the policy or that the community character of the property of the insured and his wife in the policy was destroyed. (R. 22-23.)

Thereafter on such date, the insured entered into a trust agreement with the insurance company by the terms whereof the insurance company agreed to receive one-half of the proceeds of the policy as trustee and to pay the funds so held and the interest credited thereon to taxpayer, as first beneficiary, at the rate of $100 per month, and in case of the death of taxpayer to pay the balance of the fund, in like manner, to the daughter of taxpayer, and, in the event of the death of both taxpayer and the daughter, to the executors or administrators of the last surviving beneficiary. (R. 23.)

And in like manner, on that date, the insured and the insurance company entered into a similar agreement as to the other half of the proceeds of the policy whereby the insurance company agreed to receive the other half of the proceeds of such insurance as trustee, and to pay the same over to taxpayer, as beneficiary, in monthly installments of $100 and in the event of taxpayer's death prior to the insured to pay the fund or any balance thereof, to the son of taxpayer, if living, and if both taxpayer and the son die, then to the executors or administrators of the last surviving beneficiary. (R. 23-24.)

The decedent kept up and maintained such policy intact and in full force and effect, paying all premiums thereon, until he became disabled in 1937, when pursuant to the terms of the policy, the premiums were thereafter waived. (R. 24.)

In 1937, after the decedent became disabled, taxpayer took out letters of Guardianship upon his person and estate. Thereafter, no premiums were paid, and under the terms of the contract no premiums should be paid. Such disability continued until the death of said deceased. (R. 24.)

On November 6, 1944, the decedent died, testate. Thereafter his will was admitted to probate and taxpayer was appointed executrix thereof, duly qualified as such, and ever since and up to Final Distribution and her discharge, remained the duly appointed, qualified and acting executrix of his will. (R. 24.)

By the terms of his will, the decedent left all his property, of every kind and character to taxpayer, and pursuant thereto all of his estate was duly distributed to her by Decree of Final Distribution. (R. 24.)

Taxpayer, as executrix, filed an estate tax return on the estate of the decedent and such return showed due to the United States Government by way of estate tax the sum of $10,786.15. On June 13, 1945, taxpayer, as executrix, paid that sum to James G. Smyth, Collector. Thereafter, on July 30, 1945, the Superior Court of California, for the City and County of San Francisco, made its Decree of Settlement of First and Final Account and of Final Distribution in the matter of the estate of the decedent, by the terms whereof the entire estate was distributed to taxpayer and she ever since has been, and now is, the sole owner thereof, including the claim for refund of estate tax here sued for. (R. 25.)

Thereafter, the probate Court made its order discharging taxpayer as executrix. (R. 25.)

On November 14, 1945, F. M. Harless, United States Internal Revenue Agent in Charge in San Francisco, California, made to taxpayer his report of examination of the estate tax return, indicating a deficiency of $4,290.76 in estate taxes, and fixing the claimed correct tax liability at $15,076.91 and on that date, taxpayer received from the Collector a notice of deficiency in the sum of $4,290.76, and on November 27, 1945, she forthwith paid to such Collector the amount of the deficiency, under protest, first, because 50% of the community property, to-wit, the entire estate, should have been deducted; secondly, as to the $40,000 of insurance, the insurance policy No. 8 751 507 for $15,000 was covered by the two trust agreements, and the insurance policy No. 10 899 287 for $25,000 was likewise covered by trust agreements. (R. 25-26.)

Immediately after payment of the deficiency, taxpayer filed with the Collector her claim for refund as to such taxes, and the claim for refund was referred to the Auditing Department and the Technical Staff of the Internal Revenue Department of the United States, and on August 26, 1947, such claim for refund was denied and rejected in its entirety. (R. 26.)

By reason of inclusion of the proceeds of the two insurance policies the amount of the correct tax liability of the estate was $15,076.91, as stated in the report of the agent; it is not true that there was no deficiency due or that the total amount of the tax was only $4,988.01, or that the sum paid the Collector is in excess of the proper amount of the tax, or that there is now due, owing or unpaid from the United States of America to taxpayer the sum of $10,088.90, or any part thereof. (R. 26-27.)

Policy No. 8 751 507 on the life of the insured provided that the insured might change the beneficiaries upon written notice to the home office of the insurer. In the event all beneficiaries should predecease the insured, the interest of the beneficiary was to vest in the insured. (R. 27.)

Each trust in one-half the proceeds of such policy provides that the trustee should receive from itself as insurer one-half of the proceeds of the policy in case it should become a claim because of the insured's death. Each trust named taxpayer as first beneficiary of the trust, and in the event of her death, the proceeds of the trust were to be paid in equal parts to the two children of insured and taxpayer. Each trust provided that it should become null and void if (a) the grantor revoked the appointment by written notice to the trustee; (b) the grantor should survive both beneficiaries; (c) if any change were made in the beneficiary or manner of payment of the proceeds of the policy; (d) if the policy should be surrendered for its cash surrender value; (e) if the net sum available under the policy at the time of the insured's death should be less than a certain sum; and (f) if the insured should assign the policy. (R. 27-28.)

As to policy No. 10 899 287, the policy did not provide on its face that insured might change the beneficiary in the manner provided in the policy. (R. 28.) As to change of beneficiary policy No. 10 899 287 reads (R. 28, 66):

> New York Life Insurance Company, a mutual company, agrees to pay to the executors, administrators or assigns of the insured, or to the duly designated beneficiary (with right on the part of the insured to change beneficiary in the manner provided herein) twenty-five thousand ($25,-000.00) dollars (the face of this policy), etc.

The only other reference to change of beneficiary in the policy was a ruled space at the end of its schedules labeled (R. 28, 69):

REGISTER OF CHANGE OF BENEFICIARY

NOTE—No change of beneficiary shall take effect unless indorsed on this Policy by the Company at the Home Office.

Date of Request	Beneficiary	Indorsed by
On the 24th day of February, 1930, the New York Life Insurance Company was appointed trustee as per conditions of trust agreements (2) attached hereto.		John C. McCarthy, Vice President

Taxpayer married decedent insured September 4, 1916. They had two children, both still living. Taxpayer and insured resided and made their home in this district from their marriage to the death of insured November 6, 1944. All premiums of the policies were paid with the community earnings of the insured and taxpayer. (R. 28-29.)

Upon the basis of the foregoing findings the District Court concluded as a matter of law that the $40,000 proceeds of the policies was properly included in the decedent's estate for purposes of the federal estate tax (R. 29) and judgment was accordingly entered that the taxpayer take nothing by this action and the Collector have judgment for costs (R. 30-31). Thereafter the taxpayer made a motion to amend the findings and judgment and for a new trial (R. 32-42) which the District Court denied. (R. 42-44.) The taxpayer then took this appeal. (R. 45.)

SUMMARY OF ARGUMENT.

The life insurance proceeds in question are plainly includible in the gross estate of the insured for purposes of the federal estate tax under Section 811 of the Internal Revenue Code, as amended by the Revenue Act of 1942. This is so because the premiums were all paid out of community property and the insured retained incidents of ownership in the policies and their proceeds. The taxpayer's contention that there was an oral agreement between the decedent and his wife to change the community insurance to separate property is without merit. Not only would such an agreement be repugnant to the terms of the trust agreements that were executed by the decedent with the consent of his wife, but the record affords no adequate basis for concluding that any such agreement was made. Moreover, if there had been such an arrangement it would not affect the result in the instant case because the decedent had incidents of ownership in all of the policies exercisable either alone or in conjunction with his wife. In the circumstances we submit that the District Court made no error in deciding this case in the Government's favor and holding that the proceeds of the policies are includible in the decedent's gross estate under Section 811(g) of the Internal Revenue Code, as amended.

ARGUMENT.

THE INSURANCE PROCEEDS IN QUESTION WERE PROPERLY INCLUDED IN THE GROSS ESTATE UNDER SECTION 811 OF THE INTERNAL REVENUE CODE.

Although the District Court did not write a formal opinion, still it made conclusions of law (R. 29-30), and also expressed its views to some extent at least in a memorandum accompanying the order denying the taxpayer's motion to amend the findings and judgment and for a new trial. See R. 42-44. In that memorandum the District Court pointed out (R. 43) that under the express terms of each of the trust agreements the trust was to be null and void.

> (a) if I shall revoke said appointment by written notice to said Company filed at its Home Office; (b) if both said Beneficiaries shall die before me; (c) if any change is made in the beneficiary or manner of payment of the proceeds of said policy;

> (d) if said policy shall be surrendered for Cash Surrender Value; (e) if I shall assign said policy and said assignment or written notice thereof be filed with the Company at its Home Office; (f) if at my death the net sum payable under said policy shall be less than [a certain amount].

And the District Court went on to say that it is quite clear that the trust agreements to which taxpayer gave her written consent recognized that the decedent

> retained the right to assign the policy and to revoke the appointment, and * * * the right * * * to change the beneficiary or manner of payment of proceeds and to surrender the policy for its cash value.

These are certainly substantial incidents of ownership (*Chase Nat. Bank v. United States,* 278 U. S. 327, 335; *Helvering v. Hallock,* 309 U. S. 106; Paul, Federal Estate and Gift Taxation, 1946 Supp., Sec. 10.37) and we do not understand that taxpayer is contending otherwise. However, the taxpayer contended below and here again urges (Br. 17) that there was an oral agreement between the decedent and his wife to transmute into the separate property of each spouse one-half the community insurance. In that connection the District Court took the view, correctly we submit (R. 44), that the "original negotiations merged in the writing and any verbal negotiations repugnant to the writing may not be considered"; and therefore the insurance proceeds were includible in the gross estate under Section 811(g) of the Internal Revenue Code, as amended by Section 404 of the Revenue Act of 1942 (Appendix, *infra*).

Section 811(g), as so amended, provides for the inclusion of life insurance proceeds to the extent of the amount receivable by the executor; and to the extent of the amount receivable by all other beneficiaries where the insurance was purchased with premiums paid by the decedent or with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For the purposes of the statute, premiums paid with community property are considered to have been paid by the insured, with exceptions not material here; and the term "incidents of ownership" includes incidents of ownership possessed by the decedent at his death as manager of the community. The law as so amended is applicable to estates of decedents dying after the date of enactment of the Act (October 21, 1942); but in determining the proportion of the premiums paid by the decedent the amount so paid on or before January 10, 1941, shall be excluded if at no time after such date the decedent possessed an incident of ownership in the policy.[1]

Here the decedent died in 1944, and there is no question but that all the premiums were paid prior to January 10, 1941, by the decedent out of community property and therefore if as held by the District Court

[1]It is unnecessary here to consider the changes made by Section 351 of the Revenue Act of 1948, which are effective only with respect to estates of decedents dying after December 31, 1947.

and contended by us he retained incidents of ownership in the policies after that date, then the proceeds are plainly includible in the gross estate under the statute.

In *Fernandez v. Wiener,* 326 U. S. 340, the Court upheld the constitutionality of the statute and its related provision (Section 811(e)(2) of the Internal Revenue Code, as amended by Section 402 of the Revenue Act of 1942 [Appendix, *infra*]); and in consequence the entire community property there involved (including insurance proceeds) was subjected to estate tax upon the death of the husband. In so holding, the Court rejected the contention that the wife's vested half interest was immune from inclusion in the husband's gross estate, and took the view that the cessation of the husband's extensive powers as manager of the community, and the establishment in the wife of new powers of control over her share, though it was always hers, furnished appropriate occasions for the tax.

It follows from the foregoing that if the District Court below correctly held that the alleged oral agreement may not be considered, then there is no doubt as to the tax in this case. In this connection the decision of the District Court is supported by cases holding that the parol evidence rule precludes consideration of evidence such as offered here which would contradict the express provisions of the trust agreements.

Thus, in *Pugh v. Commissioner,* 49 F. (2d) 76 (C.A. 5th), certiorari denied, 284 U. S. 642, the Court said (p. 79):

> While it is sometimes broadly stated that the parol evidence rule has no application to any save parties to the instrument and their privies, *In re Shields Brothers,* 134 Iowa 559, 111 N. W. 963, 10 L. R. A. (N. S.) 1061; *O'Shea v. N. Y. R. R. Co.* (C. C. A.), 105 F. 559; *Blake v. Hall,* 19 La. Ann. 49, yet when an instrument is executed as the final embodiment of an agreement, and becomes the act of the parties, and where the parol evidence is offered merely to vary the legal effect of its terms, the rule operates to protect all whose rights depend upon the instrument though not parties to it. *Allen v. Ruland,* 79 Conn. 405, 65 A. 138, 118 Am. St. Rep. 146, 8 Ann. Cas. and note, page 347; 10 R. C. L. § 213; 5 Wigmore on Evidence, §§ 2425, 2446; 2 Williston on Contracts, § 647. Especially are recorded muniments of title not to be altered by parol evidence except on orderly procedure for their reformation. *Blum v. Allen,* 145 La. 71, 81 So. 760. That by some other form of instrument the rights of the United States would have been different is beside the question. The parties abide by this instrument as they made it. The law, and not their wish or understanding, must control its legal effect on the incidence of taxation. The Board did not err in disregarding the parol evidence.

And the *Pugh* case was approved and followed by this Court in *Jurs v. Commissioner,* 147 F. (2d) 805, 810. See also *Grace Bros. v. Commissioner,* 173 F. (2d) 170, 175, where this Court said:

Before elaborating further on the matter, we advert to the fact that in the written documents which relate to the transaction, both before and after its consummation, no mention *whatsoever is made of the good will.* We leave aside, for the moment, the indisputable proposition that oral testimony contradicting written instruments can have no binding effect, in cases of this character. Cf. *Woodall v. Commissioner,* 9 Cir. 1939, 105 F. 2d 474, 478; *Jurs v. Commissioner,* 9 Cir. 1945, 147 F. 2d 805, 810; *Gaylord v. Commissioner,* 9 Cir., 1946, 153 F. 2d 408, 415. And see *Helvering v. Coleman-Gilbert Associates,* 1935, 296 U.S. 369, 374, 56 S. Ct. 285, 80 L. Ed. 278; *Titus v. United States,* 10 Cir., 1945, 150 F. 2d 508, 511, 162 A.L.R. 991.

Cf. *Miller v. Brode,* 186 Cal. 409; *Odone v. Marzocchi,* 89 A.C.A. 126, 131.

In the light of the foregoing considerations we submit that the Court below committed no error in deciding this case as it did and holding that the insurance proceeds in question are properly includible in the gross estate under Section 811(g) of the Internal Revenue Code, as amended. *Fernandez v. Wiener, supra.*

Moreover, the proceeds would also be includible in the gross estate under Section 811(c) of the Internal Revenue Code, as supplemented by Section 811(d)(5) (Appendix, *infra*), as a transfer intended to take effect in possession or enjoyment at or after the grantor's death. The policies were transfered in trust by the decedent and he retained an interest in the transferred property sufficient to support the tax. *Reinecke v. Northern Trust Co.,* 278 U. S. 339; *Helvering v. Hallock, supra; Fidelity Co. v. Rothensics,* 324 U. S. 108; *Commissioner v. Estate of Fields,* 324 U. S. 113; *Goldstone v. United States,* 325 U. S. 687; *Commissioner v. Estate of Church,* 335 U. S. 632; *Estate of Spiegel v. Commissioner,* 335 U.S. 701; *Commissioner v. Bank of California,* 155 F. 2d 1 (C. A. 9th), certiorari denied, 329 U. S. 725; *In re Rhodes' Estate,* 174 F. (2d) 584 (C. A. 3d); Treasury Regulations 105, Section 81.17, as amended (Appendix, *infra*); I Paul, Federal Estate and Gift Taxation (1942) and 1946 Supplement, Section 7.08.

The proceeds would also be includible in the gross estate under Section 811(d)(2) of the Internal Revenue Code, as supplemented by Section 811(d)(5) (Appendix, *infra*), which provides for taxation where the enjoyment of the property was subject at the date of the grantor's death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend or revoke. *Commissioner v. Estate of Holmes,* 326 U. S. 480; *Porter v. Commissioner,* 288 U. S. 436; *Helvering v. City Bank Co.,* 296 U. S. 85; Treasury Regulations 105, Section 81.20; I Paul, Federal Estate and Gift Taxation (1942) and 1946 Supplement, Section 7.09.

The taxpayer says (Br. 16-17) that each policy here involved was originally community property and on each occasion when the wife consented to the creation of a trust she then had a vested interest in one-half the property. While we do not think that this makes any difference here, still we would point out that some of the transactions in question took place prior to July 29, 1927, and there was a change in the California community property law as of that date. As to community property acquired prior to July 29, 1927, the wife had a mere expectancy; as to community property acquired on and after that date, her interest was "present, existing and equal." The law as to this was recently considered by this Court in *Rickenberg v. Commissioner,* decided August 22, 1949, and no extended discussion is necessary here.

Taxpayer cites (Br. 16-17) cases such as *Grimm v. Graham,* 26 Cal. (2d) 173, 175, which reiterates the long established rule that the husband can not make a valid gift of community property without the consent of his wife and if he undertakes to do so the transaction is voidable as to the wife's share. But this does not mean that he has none of the incidents of ownership in the property within the meaning of the estate tax law, and it is clear that he has. He can make a sale or transfer of community property for a consideration and the property may be subjected to the payment of his personal debts. See *Union Mutual Life Ins. Co. v. Broderick,* 196 Cal. 497; *Grolemund v. Caferata,* 17 Cal. (2d) 679, 688, certiorari denied, 314 U.S. 612; *Estate of Coffee,* 19 Cal. (2d) 248, 252; *Stratton v. Superior Court,* 87 Cal. App. (2d) 809, 811. And the statute (Section 811 (g)(4) of the Internal Revenue Code, as amended, *supra*) expressly provides with reference to community property that the term "incidents of ownership" includes incidents of ownership possessed by the decedent as manager of the community. And see Paul, Federal Estate and Gift Taxation, 1946 Supplement, Section 10.40, p. 378.

We recognize of course that in California a husband and wife may by agreement change community property to separate property (*Rickenberg v. Commissioner, supra*) but here there was no such agreement, and even if there had been one it would not affect the tax in this case because the husband had incidents of ownership in all of the policies, exercisable either alone or in conjunction with the wife.

Moreover, even if it be assumed *arguendo* that there was such a division of property in the instant case that husband and wife each owned one-half as separate property and the decedent had no incidents of ownership at all in the wife's share, still it would not follow that all of the proceeds would be excludible and one-half of them would of course be includible in the gross estate. Cf. *Rule v. United States,* 63 F. Supp. 351 (C. Cls.).

However, we do not mean to intimate that there was any change from community to separate property in the instant case. The record affords no adequate basis for such a conclusion. Indeed, taxpayer does not point to any specific agreement for such a change and she merely urges (Br. 17) that the husband's statement that he would keep up the insurance for her and the children (R. 19) had the legal effect of transmuting into the separate property of each spouse one-half of the community insurance. Also (Br. 18) that as a result of that agreement and the transfers in trust to which it was collateral, the wife and children acquired an equitable interest which the insured could not have destroyed. Taxpayer attempts to bolster her contentions by citing (Br. 17) cases such as *United States v. Pierotti*, 154 F. (2d) 758 (C.A. 9th), in support of the proposition that a change from community to separate property may be effectuated by a very informal oral agreement.

Whatever may be the scope of the *Picrotti* case and others like it, we do not understand that they were intended to override the parol avidence rule in circumstances like we have here; but even if it be thought, contrary to our views and the holding of the District Court, that evidence of the alleged oral agreement should be considered, still the result would not be changed. Of course the taxpayer has the burden of proof (*Greenwood v. Commissioner*, 134 F. (2d) 915, 919 (C.A. 9th)), and we submit that the record in the instant case would not justify the District Court in concluding that there was any agreement to change from community to separate property.

At most, the alleged oral agreement would be merely one to keep up the insurance for the wife and children, and certainly that would not be inconsistent with the retention by the decedent of a reversionary interest in the property. Each of the trust agreements in the instant case expressly provided (R. 43) that the trust should be null and void if the beneficiaries died before the insured so that if he had survived them he would have regained complete control of the insurance. And it is settled that such an interest is an incident of ownership sufficient to support taxation. *Commissioner v. Estate of Church, supra; Estate of Spiegel v. Commissioner, supra; Fidelity Co. v. Rothensies, supra; Commissioner v. Estate of Field, supra; Hock v. Commissioner,* 152 F. (2d) 574 (C.A. 8th); *Liebman v. Hassett,* 148 F. (2d) 247 (C.A. 1st); *Schongalla v. Hickey,* 149 F. (2d) 687 (C.A. 2d), certiorari denied, 326 U. S. 736; *Chase Nat. Bank v. United States,* 116 F. (2d) 625 (C.A. 2d.)[2]

However, we do not have to place our sole reliance upon the retention of a reversionary interest here, for as shown above and in the order of the District Court, there can be no question but that the decedent also retained other valuable incidents of ownership in the policies. Indeed, it will be noted that after the decedent became disabled, the wife acting as his guardian borrowed on the policies (R. 94-96) and this was certainly the exercise of an incident of ownership within the meaning of the law.

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[2]The 1942 amendments to subdivision (g) did not change the law in any way which would preclude taxation in the instant case. True, Section 811(g)(2) as so amended, does provide that for the purposes of clause (B), the term "incident of ownership" does not include a reversionary interest, but that presupposes that the decedent did not pay the premiums and here he did. Where, as here, the premiums are paid by the decedent, even though out of community property, a reversionary interest is still an incident of ownership for purposes of applying the premium payment test to payments made on or before January 10, 1941. See Treasury Regulations 105, Section 81.27 (Appendix, infra); Paul, Federal Estate and Gift Taxation, 1946 Supplement, Section 10.37, p. 371.

Cases such as *Thomson v. Thomson,* 156 F. (2d) 581 (C.A. 8th), certiorari denied, 329 U.S. 793; *Dixon Lumber Co. v. Peacock,* 217 Cal. 415; *Shoudy v. Shoudy,* 55 Cal. App. 344, cited by taxpayer (Br. 18), are not tax cases; they turn on their peculiar facts and we do not read any of them as being at variance with our position here.

Nor can taxpayer derive any comfort from cases (*Morse v. Commissioner,* 100 F. (2d) 593 (C.A. 7th); *Commissioner v. Sharp,* 91 F. (2d) 804 (C.A. 3d); *Helvering v. Parker,* 84 F. (2d) 838 (C.A. 8th); *Pennsylvania Co., etc. v. Commissioner,* 79 F. (2d) 295 (C.A. 3d) cited on pages 18-19 of her brief. Those cases all presuppose that no incident of ownership was retained and they are distinguishable from the instant one where the insured retained incidents of ownership and the District Court so found. Moreover, those cases were all decided before *Helvering v. Hallock, supra,* which changed the law as to the effect of retaining a reversionary interest; and to the extent that they are opposed to *Hallock* they should of course no longer be followed. See, for example, *Schultz v. United States,* 140 F. (2d) 945, 949 (C.A. 8th), where *Helvering v. Parker* was expressly overruled as a result of *Helvering v. Hallock;* see also *Hock v. Commissioner, supra,* 152 F. (2d) 574 at 576; *Chase Nat. Bank v. United States, supra,* 116 F. (2d) 625 at 627.

In the light of the foregoing considerations, we submit that the District Court made no error in any of its findings, conclusions or rulings in the instant case. They are in all respects correct and the judgment should be upheld by this Court.

CONCLUSION.

The judgment of the District Court should be affirmed.

Dated, October 24, 1949.

Respectfully submitted,

THERON LAMAR CAUDLE,
Assistant Attorney General,
ELLIS N. SLACK,
LEE A. JACKSON,
L. W. POST,
Special Assistants to the Attorney General,
FRANK J. HENNESSY,
United States Attorney,
C. ELMER COLLETT,
Assistant United States Attorney,
Attorneys for Appellee.

(Appendix Follows.)

Appendix.

Internal Revenue Code:

Sec. 88. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States——

* * * * * * *

(c) *Transfers in Contemplation of, or Taking Effect at Death.*—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, or of which he has at any time made a transfer, by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * *

(d) *Revocable Transfers.*—

* * * * * * *

(2) *Transfers on or prior to June 22, 1936.*—To the extent of any interest therein of which the dece-

dent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. * * *

*   *   *   *   *   *   *

(5) [as added by Section 402(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798.] *Transfers of Community Property in Contemplation of Death, Etc.*—For the purposes of this subsection and subsection (c), a transfer of property held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse.

(e) [as amended by Section 402(b) of the Revenue Act of 1942, *supra.*] *Joint and Community Interests.*—

*   *   *   *   *   *   *

(2) *Community Interests.*—To the extent of the interest therein held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States,

or any foreign country, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition.

* * * * * * *

(g) [as amended by Section 404(a)of the Revenue Act of 1942, *supra.*] *Proceeds of Life Insurance.*—

(1) *Receivable by the Executor.*—To the extent of the amount receivable by the executor as insurance under policies upon the life of the decedent.

(2) *Receivable by Other Beneficiaries.*—To the extent of the amount receivable by all other beneficiaries as insurance under policies upon the life of the decedent (A) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, or (B) with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. For the purposes of clause (A) of this paragraph, if the decedent transferred, by assignment or otherwise, a policy of insurance, the amount paid directly or indirectly by the decedent shall be reduced by an amount which bears the same

ratio to the amount paid directly or indirectly by the decedent as the consideration in money or money's worth received by the decedent for the transfer bears to the value of the policy at the time of the transfer. For the purposes of clause (B) of this paragraph, the term "incident of ownership" does not include a reversionary interest.

(3) *Transfer Not a Gift.*—The amount receivable under a policy of insurance transferred, by assignment or otherwise, by the decedent shall not be includible under paragraph (2)(A) if the transfer did not constitute a gift, in whole or in part, under Chapter 4, or, in case the transfer was made at a time when Chapter 4 was not in effect, would not have constituted a gift, in whole or in part, under such chapter had it been in effect at such time.

(4) *Community Property.*—For the purposes of this subsection, premiums or other consideration paid with property held as community property by the insured and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered to have been paid by the insured, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse; and the term "incidents of ownership" includes incidents of ownership possessed by the decedent at his death as manager of the community.

(h) *Prior Interests.*—Except as otherwise specifically provided therein, subsections (b), (c), (d), (e), (f), and (g) shall apply to the transfers, trusts, estates, interests, rights, powers, and relinquishment of powers, as severally enumerated and described therein, whether made, created, arising, existing, exercised, or relinquished before or after February 26, 1926.

* * * * * * *

(26 U.S.C. 1946 ed., Sec. 811.)

Revenue Act of 1942, c. 619, 56 Stat. 798:

Sec. 404. PROCEEDS OF LIFE INSURANCE.

* * * * * * *

(c) *Decedents to Which Amendments Applicable.*—The amendments made by subsection (a) shall be applicable only to estates of decedents dying after the date of the enactment of this Act [October 21, 1942]; but in determining the proportion of the premiums or other consideration paid directly or indirectly by the decedent (but not the total premiums paid) the amount so paid by the decedent on or before January 10, 1941, shall be excluded if at no time after such date the decedent possessed an incident of ownership in the policy.

Treasury Regulations 105, promulgated under the Internal Revenue Code:

Sec. 81.15 [as amended by T.D. 5239, 1943, Cum. Bull. 1081, 1084, and further amended by T.D. 5699, 1949-12 Int. Rev. Bull. 5, 11.] *Transfers during life.*—

* * *

In the case of estates of decedents dying after October 21, 1942, and on or before December 31, 1947, a transfer to a third party or third parties of property held as community property by the decedent and spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered, in accordance with section 811(d)(5), as added by section 402(a) of the Revenue Act of 1942, for the purposes of this section and sections 81.16 through 81.21, inclusive, to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the spouse or derived originally from such compensation or from separate property of the spouse. The same statutory provisions apply in the case of a division of such community property between the decedent and spouse into separate property, and in the case of a transfer of any part of the community property into separate property of such spouse; in such cases, the value of the property which becomes the separate property of such spouse, with the exception stated in the preceding sentence, shall be included in the gross estate of the decedent under section 811(c) or section 811(d), if the other conditions of taxability under such sections exist. If in the case of a decedent who died after October 21, 1942, and on or before December 31, 1947, property held as community property by such decedent and his spouse is transferred to themselves as joint tenants or as tenants by the entirety, the transfer is taxable under section 811(c), except with respect to such part of the property so transferred as is attributable to the spouse under the exception stated in the first sentence of this paragraph. With respect to the meaning of property derived originally from such compensation or from separate property of the spouse and to the identification required, see section 81.23. (With respect to estates of decedents dying after December 31, 1947, and on or before April 2, 1948, involving transfers of community property, see section 81.23.)

Sec. 81.17 [as amended by T.D. 5512, 1946-1 Cum. Bull. 264, and further amended by T.D. 5741, 1949-20 Int. Rev. Bull. 10.] *Transfers Intended to Take Effect at or After the Decedent's Death.*—A transfer of an interest in property by the decedent during his life (other than a *bona fide* sale for an adequate and full consideration in money or money's worth) is "intended to take effect in possession or enjoyment at or after his death," and hence the value of such property interest is includible in his gross estate, if

(1) possession or enjoyment of the transferred interest can be obtained only by beneficiaries who must survive the decedent, and

(2) the decedent or his estate possesses any right or interest in the property (whether arising by the express terms of the instrument of transfer or otherwise).

A right to the possession or enjoyment of, or a right to the income from, the property, or the right to designate the persons who shall possess or enjoy the property or the income therefrom, constitutes a right or interest in the property. (See also sections 81.18 and 81.19.) Where possession or enjoyment of the transferred interest can be obtained by beneficiaries either by surviving the decedent or through the occurrence of some other event or through the exercise of a power, subparagraph (1) shall not be considered as satisfied unless, from a consideration of the terms and circumstances of the transfer as a whole, the power or event is deemed to be unreal, in which case such event or power shall be disregarded. Except as provided in the next to the last paragraph of this section, the value of the property so transferred is includible without regard to the date when the transfer was made, whether before or after the enactment of the Revenue Act of 1916.

*   *   *   *   *   *   *

In the case of a decedent who died on or before January 17, 1949, the date of the decision of the United States Supreme Court in *Commissioner v. Estate of Francois L. Church,* 335 U.S. 632, property transferred by the decedent shall not be included in his gross estate under this section if the decedent's only right or interest in the property consisted of an estate for life. (See, however, sections 81.18 and 81.19.)

Sec. 81.23 [as amended by T.D. 5239, *supra,* pp. 1085-1086, and further amended by T.D. 5699, *supra.*] *Community Property.*—In the case of estates of decedents dying after October 21, 1942, and on or before December 31, 1947, the gross estate includes the entire community property held by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the spouse or derived originally from such compensation or from separate property of the spouse. Section 811(e)(2) also provides that in no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition.

Property derived originally from compensation for personal services actually rendered by the spouse or from separate property of the spouse includes property that may be identified as (1) income yielded by property received as such compensation or by such separate property, and (2) property clearly traceable (by reason of acquisition in exchange, or other derivation) to property received as such compensation, to such separate property, or to such income. The rule established by this statute for apportioning the respective contributions of the spouses is applicable regardless of varying local rules of apportionment, and State presumptions are not operative against the Commissioner. The burden of identifying the property which may be excluded from the community interest rests upon the executor.

With respect to estates of decedents dying after October 21, 1942, and on or before December 31, 1947, see the provisions of section 81.15, section 81.22, and section 81.17(b), relating, respectively, to the inclusion of transfers of community property during life, the treatment of joint tenancies and tenancies by the entirety created by the transfer of community property, and the treatment of insurance upon the decedent's life held as, or acquired with, community property.

In the case of a decedent who died after December 31, 1947, and on or before April 2, 1948, the provisions contained in the first two paragraphs of this section and those provisions of sections 81.15, 81.22 and 81.27(b) referred to in the preceding paragraph may have a limited effect. Although such provisions are not applicable for the purpose of determining the value of the decedent's gross estate, the estate tax payable is, nevertheless, not to exceed the estate tax which would be imposed if such provisions were applicable.

Sec. 81.25 [as amended by T.D. 5239, *supra,* p. 1092.] *Life Insurance.*—Section 811(g) provides for the inclusion in the gross estate of insurance on the decedent's life (a) receivable by or for the benefit of the estate (for which see section 81.26), and (b) receivable by other beneficiaries (for which see section 81.27).

The term "insurance" refers to life insurance of every description, including death benefits paid by fraternal beneficial societies operating under the lodge system.

Life insurance not includible in the gross estate under the provisions of subsection (g) of section 811 and section 81.26, 81.27, or this section may, depending upon the facts of the particular case, be includible under some other subsection of section 811 and the sections of these regulations pertaining thereto. Thus in the case of insurance upon his own life which the decedent fully paid up prior to January 10, 1941, the date of Treasury Decision 5032 [C.B. 1941-1, 427], and which he gratuitously transferred prior to such date in contemplation of death, the insurance proceeds are includible in his gross estate under section 811(c). * * *

Sec. 81.27 [as amended by T.D. 5239, *supra,* and further amended by T.D. 5699, *supra*, p. 13.] *Insurance Receivable by Other Beneficiaries.*—(a) *In case of decedent dying after December 31, 1947.*— The regulations prescribed under this paragraph (except as otherwise indicated in this section) are applicable only in the case of decedents who died after December 31, 1947. In such cases the amount of the aggregate proceeds of all insurance on the life of the decedent not receivable by or for the benefit of his estate must also be included in his gross estate as follows:

(1) Such insurance (not includible under (2) of this paragraph) purchased with premiums, or other consideration, paid directly or indirectly by the decedent, in the proportion that the amount so paid by the decedent bears to the total premiums paid for the insurance, and

(2) Such insurance with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any person.

The purchase of insurance upon the life of the decedent is attributed to the decedent even though the premiums, or other consideration, are paid only indirectly by the decedent. As thus used, the phrase "paid indirectly by the decedent" is intended to be broad in scope. For example, if the decedent transfers funds to his wife so that she may purchase insurance on his life, and she purchases such insurance, the payments are considered to have been made by the decedent even though they are not directly traceable to the precise funds transferred by the decedent. A decedent similarly pays the premiums or other consideration if payment is made by a corporation which is his alter ego or by a trust whose income is taxable to him, as, for example, a funded insurance trust. A payment is also made by the decedent if the decedent's employer makes the payment as compensation for services.

For the purposes of this paragraph, where premiums or other consideration are paid with property held as community property by the decedent and his spouse, the decedent shall (in the absence of additional circumstances showing payment indirectly by the decedent) be deemed to have paid only one-half of such premiums or other consideration. The general rule stated in the preceding sentence is not applicable unless the decedent and his spouse had equal and existing interests in the community property used in the payment of the premiums or other consideration. An example of additional circumstances showing payment indirectly by the decedent which will render inapplicable the general rule is a transfer of property by the decedent to the community for the purpose of purchasing the insurance.

The amount receivable under a policy of insurance transferred, by assignment or otherwise, by the decedent shall be includible under (1) of this paragraph if the transfer constituted a gift to any extent under Chapter 4 of the Internal Revenue Code, or in case the transfer was made at a time when such chapter was not in effect, would have constituted a gift to any extent under such chapter had it been in effect at such time. The determination of whether a transfer constitutes (or would have constituted) a gift to any extent under Chapter 4 is to be made with respect to the concept of gifts under Chapter 4 and not with respect to the taxability of a particular transfer as a gift under Chapter 4 by reason of the amount of any exclusion or specific exemption allowed under such chapter. Thus, if the decedent transferred a policy to his creditors in consideration of the discharge of his obligations, and there was no element of donative intent in the transfer, no part of the proceeds would be includible in the gross estate. If the transfer conforms to any extent to the concept of a gift under Chapter 4, the formula stated in the next paragraph for determining the portion of the proceeds includible in the gross estate is applicable.

For the purpose of determining the portion of the insurance purchased by the decedent where the decedent transferred, by assignment or otherwise, a policy of insurance, the amount paid directly or indirectly by the decedent shall be reduced by an amount which bears the same ratio to the amount paid directly or indirectly by the decedent before such transfer as the consideration in money or money's worth received by the decedent for the transfer bears to the value of the policy at the time of the transfer. For example, assume the decedent purchased for a single premium of $600 an insurance policy paying $1,200 upon his death. If at a time when the replacement cost of the same or a similar policy is $900, the decedent gives such policy to his wife for a partial consideration of $600, the $600 premium originally paid by the decedent would be reduced by an amount which bears the same ratio to $600 (the amount paid by the decedent) as $600 (the consideration paid by the wife) bears to $900, or by $400. Therefore, the decedent will be considered to have paid $200 in premiums and 200/600 of the $1,200 proceeds, or $400, will be included in his gross estate.

For the purposes of (1) of this paragraph, in determining the proportion of the premiums or other consideration paid directly or indirectly by the decedent (but not the total premiums paid) the amount so paid by the decedent on or before January 10, 1941, shall be excluded if at no time after such date the decedent possessed an incident of ownership in the policy. For the purpose of the preceding sentence a reversionary interest is an incident of ownership.

For the purposes of this section, the term "incidents of ownership" is not confined to ownership in the technical legal sense. For example, a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder is an incident of ownership in the decedent. For examples of "incidents of ownership" see paragraph (c) of this section. Section 811 (g)(2), as added by the Revenue Act of 1942, expressly provides that for the purposes of section 811(g)(2)(B) (see (2) of this paragraph), but not for the purposes of section 811(g)(2)(A) (see (1) of this paragraph), the term "incidents of ownership" does not include a reversionary interest. However, an assignment of an insurance policy by a decedent possessing other incidents of ownership therein under which he reserves a reversionary interest may result in the proceeds of the policy being includible in his gross estate under section 811(c). See section 81.25.

In determining whether the decedent possessed an incident of ownership in a policy or in any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy. As an example, assume that the decedent purchased a policy of insurance on his life with funds held by him and his surviving wife as community property, designating their son as beneficiary but retaining the right to surrender the policy. Under the local law, the proceeds upon surrender would have inured to the marital community, and the wife's transfer of her one-half interest in the policy was not considered absolute prior to the decedent's death. Upon the wife's prior death, one-half of the value of the policy would have been included in her gross estate. Under these circumstances, the power of surrender possessed by the decedent as agent for his wife with respect to one-half of the policy is not, for the purposes of this paragraph, considered an "incident of ownership", and the decedent is, therefore, deemed to possess an incident of ownership in only one-half of the policy.

With respect to estates of decedents dying after December 31, 1947, and on or before April 2, 1948, involving insurance held as community property by the decedent and spouse, or acquired with property so held, see section 81.23.

(b) *In case of decedent dying after October 21, 1942, and on or before December 31, 1947.*—The regulations prescribed under this paragraph (except as otherwise indicated in this section) are applicable only in the case of decedents who died after October 21, 1942, and on or before December 31, 1947. In such cases, the regulations prescribed under paragraph (a) with respect to estates of decedents dying after December 31, 1947, are also applicable (except to the extent inconsistent with this paragraph). For the purposes of this paragraph, premiums or other consideration paid with property held as community property by the insured and spouse under the law of any State, Territory, or possession of the United

States, or any foreign country, shall be considered to have been paid by the insured, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the decedent's spouse or derived originally from such compensation or from separate property of such spouse. With respect to the meaning of property derived originally from such compensation or from separate property of the decedent's spouse, see section 81.23. Section 811(g)(4) provides that the term "incidents of ownership" includes incidents of ownership possessed by the decedent as manager of the community where the insurance policy is property held as community property by the decedent and spouse.

*   *   *   *   *   *   *